Global Future Council on International Trade and Investment

The Future of Trade and Investment: A Call to Prevent Economic Fragmentation

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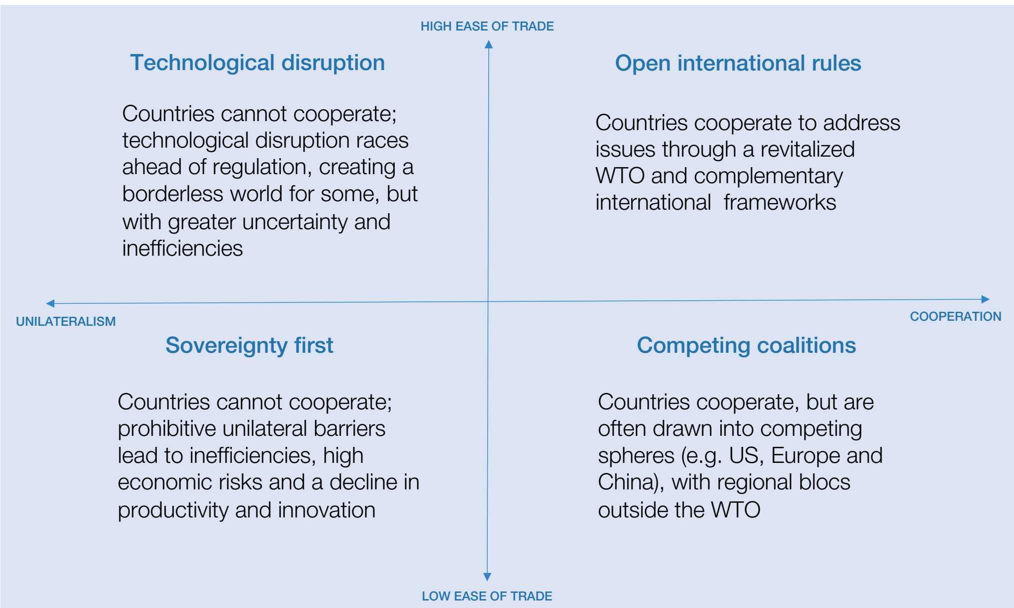
In the face of rising geopolitical tensions between the world's major economies and deepening populist discontent across many parts of the globe, the World Economic Forum Global Future Council on International Trade and Investment produced a brief[1] last year outlining four potential scenarios for global trade and investment (Figure 1).

Figure: Four scenarios for the future of trade and investment



Source: *Yeling Tan and Anabel González (2019)*

The briefing paper asked whether it was possible to maintain a world of open international rules and find ways to cooperate through a revitalized World Trade Organization (WTO), or risk sliding into competing coalitions drawn into separate regional spheres. Alternatively, would a "sovereignty-first" approach take hold, undermining cooperative agreements, raising economic risks and driving down productivity and innovation for all? Or would technological disruption race ahead of regulation, allowing for economic exchange for a select few but amidst heightened uncertainty?

Taking stock one year later, actions and measures show the world veering towards a "sovereignty-first" scenario. Over the past 12 months, there has been an escalation in the use of tariffs as a trade weapon. The US has imposed duties on $360 billion worth of Chinese products while China has set retaliatory tariffs on imports of $110 billion worth of US goods, with threats of more to come. The "Phase One" deal[2] is unlikely to entirely resolve this dispute. The enactment of export controls on technology sales to Chinese companies hurts not just those firms, but also American businesses with commercial relationships with China.

Heightened screening activity in the Committee on Foreign Investment in the United States (CFIUS) has dampened investment flows and investor confidence. The use of the national security exception to justify trade restrictions – first invoked by the US – has already spread to other countries, most notably in trade tensions between Japan and Korea, and threatens to further undermine the multilateral foundations for cooperation built up after World War II. The imposition of visa restrictions on foreign diplomats and immigrants seeking entry into the US risks harming the exchange of human capital and ideas that fuels innovation. A recent influential report[3] calling for restrictions to be placed on the access of Chinese firms to US stock markets, and to reduce US reliance on medical products from China, signals that this trend is set to continue.

Europe is not exempt from the turmoil. In addition to navigating the US-China confrontation, the European Union is itself a target of the US's disruptive trade stance. Continued ambiguity around the timing and manner of the United Kingdom's exit from the European Union has only served to deepen economic volatility and uncertainty. At the same time, growing populist discontent and the strengthening of far-right parties in several countries signal a turn away from global engagement that might be difficult to reverse. The splintering of trust between the US and China – arguably the most important bilateral economic relationship underpinning global prosperity – alongside a similar erosion of faith between citizens and their governments in many parts of the world, presents a dangerous and highly combustible situation for all.

In parallel, there are increasing signs that the world might be moving towards a paradigm of competing coalitions, not just in the trade and investment arena but also in emerging issues such as data governance. The recent emergence of "mini-deals" does not advance the global economy towards greater cooperation, but rather reinforces the use of managed trade to deal with tensions between countries. These "mini-deals" – based as they are upon political intervention around narrow issues rather than broad-based cooperation – threaten to undermine the WTO's most-favoured nation principle and erode the long-standing consensus around non-discrimination and reciprocity that have underpinned much of the world's post-war prosperity.

In terms of investment, China's Belt and Road Initiative (BRI) appears to have sparked other outward investment efforts that have been portrayed as competitors to the initiative (e.g. the Indo-Pacific strategy, or the EU-Japan investment cooperation pact). While a severe gap in infrastructure funding impacts much of the developing world, such competing efforts risk driving wedges between regions instead of fostering global development. Most countries fear being put in a zero-sum position of having to choose between the US and China, or between rival spheres.

In terms of data governance, the world continues to move towards the three distinct approaches outlined a year ago: the American emphasis on defending the free flow of data across borders, the European approach centred around privacy and consumer protection and the Chinese emphasis on cyber sovereignty. As the digital component of economic and social activities increases, there is a stronger likelihood that "switching costs" and the risk of disputes between these competing spheres of governance will increase for ordinary citizens as well as business.

The consequences of this economic fragmentation should not be underestimated. The combination of beggar-thy-neighbour tariffs, unilateral barriers against flows of people, goods, services and capital, heightened nationalist rhetoric from many quarters, growing politicization of trade and investment agreements and competing coalitions looks set to put the world on a path of greater risk, uncertainty, economic decline and geopolitical conflict – the impact of which may be felt for several generations to come. Global growth is on a downward trend, and projections for 2019 indicate that growth is at its slowest since the global financial crisis a decade ago. Greater risks and trade policy uncertainty have disrupted the ability of business to plan for the long term or to engage in spending on capital goods, with technology-based global supply chains at risk of being upended. Global investment flows have declined in developed and emerging economies, and trade activity has similarly weakened to almost negligible growth, with negative impacts on not only multinational firms but also small and medium-sized enterprises.[4]

A less visible, but equally crucial, threat to the global economy is the erosion of the multilateral rules which for the past seven decades have served as the basis for global cooperation and prosperity. The WTO is confronting its most fundamental crisis since its creation, in particular in relation to its system for the orderly settlement of trade disputes. A "sovereignty-first" world of unilateralism would mean that firms, associations and citizens could no longer rely on a common and enforceable set of principles facilitating cross-border exchanges. Without a strong global infrastructure for cooperation, cross-border interactions would instead be accompanied by frictions, greater unpredictability and heightened risks for dispute escalation. Business ability to plan and invest for the future would be greatly hampered, driving an increase in unemployment and fueling the likelihood of growing domestic dissatisfaction. The gains in productivity and innovation from recent decades would likely be replaced by permanently heightened risks of geopolitical and local conflict, as well as economic stagnation.

To halt this downward spiral, the world's leaders must take immediate, concerted action to restore global cooperation. The decline in trust between the US and China, particularly in the arena of technology policy, could be tackled through dialogue aimed at exploring mutually acceptable verification and risk mitigation mechanisms. In turn, this would go a long way towards easing global tensions and limiting the spillover of bilateral tensions. To avoid the splintering of the global economy into competing zones, efforts to emphasize areas of commonality between different initiatives can help to reduce the politicization of trade and investment. The Asian Infrastructure Investment Bank (AIIB), for example, provides a leading example of a China-led initiative grounded in multilateral rules with complementary participation by other international organizations. At the same time, revised rules to address the impact of domestic distortions on a level playing field for trade need to be negotiated, in a plurilateral format, with all key players involved.

Amid this gloomy landscape, there are some silver linings which indicate that the slide towards global fragmentation could still be arrested. Over the past year, numerous open regional trade agreements have either been signed or moved forward in implementation. Examples include the reaching of an "agreement in principle" of the EU-Mercosur trade agreement, with a chapter on sustainable development that aligns with efforts to implement the Paris Climate Agreement, and the coming into force of the African Continental Free Trade Area, with its commitment to reduce trade frictions, including in services trade. The continued implementation of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership offers a way forward for a more flexible multilateralism, where deeper integration is pursued by some members under rules that remain complementary to, rather than substitutes for, WTO rules. This builds on the continued use of open plurilateral agreements, while the WTO's Joint Statement Initiatives (such as on e-commerce and investment facilitation) offer yet another flexible approach to permit deeper integration at different speeds for different members. Completing the WTO Agreement on Fisheries Subsidies would send another positive signal to the global community about the possibility of revitalizing the multilateral trading system while doing good for the environment. Finally, solving the Appellate Body crisis is an urgent priority to avoid trade disputes spiraling into trade wars.

With political leadership, action can – and must – be taken to build on these initiatives. Trade is a formidable force for good and can support inclusion and sustainability, as well as address challenges associated with technology, investment, taxation and development. However, to leverage the power of trade, it is important to strengthen the architecture of the global trading system so that it can serve the world for many years to come. Now is the moment to reaffirm the importance of a predictable and inclusive, rules-based system. This will require concrete, concerted action by government, business and civil society to reform global economic governance and support the global good.

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[1] Yeling Tan and Anabel González, "Four Scenarios for the Future of Trade and Investment", World Economic Forum Global Future Council on International Trade and Investment, 2019, http://www3.weforum.org/docs/WEF_Global_Future_Council_on_Trade_and_Investment_Crisis_Brief_2019.pdf [Access date 11 December 2019].

[2] The Phase One deal includes commitments by China to address longstanding intellectual property and forced technology transfer concerns, import increased quantities of certain US goods and services, sign on to rules to prevent currency manipulation and open up its agricultural and financial services markets to US companies. See United States Trade Representative, "Agreement between the United States of America and the People's Republic of China: Fact Sheet", 13 December 2019, https://ustr.gov/sites/default/files/US-China-Agreement-Fact-Sheet.pdf.

[3] US-China Economic and Security Review Commission, *2019 Annual Report*, https://www.uscc.gov/annual-report/2019-annual-report-0 [Access date 11 December 2019].

[4] All trends drawn from the IMF, World Economic Outlook, October 2019, https://www.imf.org/en/Publications/WEO/Issues/2019/10/01/world-economic-outlook-october-2019 [Access date 11 December 2019].

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